

**Pre-Filing Season Activities to Address  
Specific Individual Electronic Filing Issues  
Were Adequately Conducted**

**March 2003**

**Reference Number: 2003-40-073**

**This report has cleared the Treasury Inspector General for Tax Administration disclosure review process and information determined to be restricted from public release has been redacted from this document.**



DEPARTMENT OF THE TREASURY  
WASHINGTON, D.C. 20220

INSPECTOR GENERAL  
for TAX  
ADMINISTRATION

March 18, 2003

MEMORANDUM FOR COMMISSIONER, WAGE AND INVESTMENT DIVISION

*Gordon C. Milbourn III*

FROM: Gordon C. Milbourn III  
Acting Deputy Inspector General for Audit

SUBJECT: Final Audit Report - Pre-Filing Season Activities to Address  
Specific Individual Electronic Filing Issues Were Adequately  
Conducted (Audit # 200240079)

This report presents the results of our review to determine the state of readiness of the Internal Revenue Service (IRS) to accept individual electronically filed tax returns for processing during the 2003 Filing Season.<sup>1</sup>

In order for the IRS to accurately process the 54.3 million electronic tax returns expected in 2003, the computer programs must reflect the latest changes in tax law. The various IRS branches involved depend on each other to provide timely information, make the programming changes, and test the systems prior to receiving the first tax returns in January.

This audit was limited in scope to the pre-filing season activities necessary to ensure the acceptance of electronic returns that may be affected by tax law changes relating only to Education and Retirement provisions. We reviewed what the IRS had done to implement these changes for electronically filed tax returns. We did not identify any conditions with the implementation of the Education or Retirement tax law changes that could adversely affect the acceptance of electronically filed tax returns for processing during the 2003 Filing Season.

The IRS was not required to respond to this report because it does not include any recommendations. However, IRS management officials reviewed it prior to issuance.

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<sup>1</sup> Filing Season refers to the first half of the calendar year when most individual income tax returns are filed and processed.

Copies of this report are also being sent to the IRS managers who are affected by the report results. Please contact me at (202) 622-6510 if you have questions or Michael R. Phillips, Assistant Inspector General for Audit (Wage and Investment Income Programs), at (202) 927-0597.

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### **Background**

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Section 2001(a) of the Internal Revenue Service (IRS) Restructuring and Reform Act of 1998 (RRA 98)<sup>1</sup> indicates that the IRS is to have 80 percent of all tax and information returns filed electronically by 2007. In the 2002 Filing Season,<sup>2</sup> the IRS processed more than 46.8 million electronic tax returns for taxpayers, which represents 35.6 percent of the total 131.4 million United States Individual Income Tax Returns (Form 1040 series) filed. Most forms and schedules used by individual taxpayers are now available to be filed electronically, and the IRS is expecting to process 54.3 million individual electronic tax returns in 2003.

Taxpayers have three ways to send their tax return information electronically to the IRS for acceptance. First, taxpayers may use a paid preparer who submits the tax return information to the IRS electronically as part of his or her service. Second, taxpayers may use a software program to complete their own tax returns on a personal computer and transmit the information to the software company that in turn submits it to the IRS electronically. (This also includes on-line tax preparation services.) Third, taxpayers may use the IRS' TeleFile service. This service allows certain taxpayers<sup>3</sup> to submit their information over the telephone if they received a TeleFile package from the IRS.

In order to accept and process electronic tax returns, the IRS must incorporate tax law changes into its computer programs. The IRS uses the Legislative Implementation Tracking System to track implementation of any tax law changes. The RIS<sup>4</sup> Tracking and Reporting System lists the individual computer programming changes requested to be

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<sup>1</sup> IRS Restructuring and Reform Act of 1998 (RRA 98), Pub. L. No. 105-206, 112 Stat 685 (codified as amended in scattered sections of 2 U.S.C., 5 U.S.C., 5 U.S.C. app., 16 U.S.C., 19 U.S.C., 22 U.S.C., 23 U.S.C., 26 U.S.C., 31 U.S.C., 38 U.S.C., and 49 U.S.C.).

<sup>2</sup> Filing Season refers to the first half of the calendar year when most individual income tax returns are filed and processed.

<sup>3</sup> Taxpayers must have taxable income below \$50,000 and no dependents, and file a Form 1040EZ tax return as single or married filing jointly.

<sup>4</sup> Request for Information Services (RIS).

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made to IRS computer systems to implement these tax law changes.

To help ensure return acceptance prior to processing electronically filed returns, the Wage and Investment (W&I) Division Individual Electronic Filing Branch has responsibility for the Participants Acceptance Testing System that approves vendor-developed software used to submit electronic tax returns to the IRS. A vendor is selected to develop tax scenarios that are used for the “answer file.” The IRS then uses the “answer file” to allow software vendors to test their commercial offerings and be approved by the IRS when their software computes the same results as the “answer file.”

To help ensure the electronic filing programs are updated with the next year’s requirements and other appropriate changes prior to live<sup>5</sup> processing of electronically filed returns, the Individual Electronic Filing Branch writes a RIS for the programming changes affecting electronically filed tax returns. The RIS provides a common framework to document, control, monitor, and track the changes to IRS computer systems. After the Individual Electronic Filing Branch writes the RIS, the Electronic Processing Branch programmers review it, provide comments, and agree to a scheduled date for implementation.

These programmers perform a courtesy review of any related changes made by personnel in the Tax Forms and Publications Branch. The RIS then goes to the Electronic Submission Testing Division where the Systems Acceptability Test (SAT) is scheduled. The SAT checks the programs to ascertain whether they do what the RIS requested and whether the information transferred from each subsystem is accurate.

This review was conducted at the New Carrollton, Maryland, facility of the IRS. The fieldwork was performed during November and December 2002 in the offices of W&I Division’s Submission Processing function. The audit was conducted in accordance with *Government Auditing*

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<sup>5</sup> The term “live” refers to returns filed by taxpayers at the beginning of the year.

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*Standards.* The scope was limited to the pre-filing season activities necessary to ensure the acceptance of electronic returns that may be affected by tax law changes relating to Education and Retirement provisions. This audit was performed to help provide reasonable assurance of the IRS' pre-filing season readiness activities for electronically filed tax returns in conjunction with another Treasury Inspector General for Tax Administration audit on required RISs for the 2003 Filing Season.<sup>6</sup> Detailed information on our audit objective, scope, and methodology is presented in Appendix I. Major contributors to the report are listed in Appendix II.

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### **Education and Retirement Tax Law Changes Should Not Adversely Affect the Acceptance of Electronically Filed Returns**

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We did not identify any conditions with the implementation of the Education or Retirement tax law changes that could adversely affect the acceptance of electronically filed tax returns in the 2003 Filing Season.

For the IRS to accurately process electronic tax returns, it must incorporate tax law changes into its systems and procedures. The IRS accepts electronically filed tax returns if they meet the record layout and minimal data checks. After being accepted by the IRS, the returns are sent through the normal tax return processing systems.

The Individual Electronic Filing Branch coordinated with the Tax Forms and Publications Branch and the Legislative Liaison to write the required documents for the electronic filing program updates for Education and Retirement changes. The documents went to the programmers to be incorporated into their schedule. The programmers then worked with information from the Tax Forms and Publications Branch to make certain the documents contained all the information they needed.

The IRS held weekly meetings to discuss any problems identified during the SAT testing. The programmers worked with the personnel in the SAT office to make any necessary changes, and the RIS writers attended these meetings when needed. Other IRS business units participated in the Information Technology and Asset

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<sup>6</sup> *Requests for Information Services Required for Tax Law Changes That Impact the 2003 Filing Season* (Audit Number 200240081).

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Management System (ITAMS). The ITAMS includes a web-based method of handling problems encountered during SAT. The Individual Electronic Filing Branch did not participate in the ITAMS.

The Electronic Tax Administration and Customer Account Services functions have maintained communication lines and coordinated their efforts on policy decisions so electronically filed tax returns would not be affected in 2003. An example was the proposed extension of the due date for electronic tax returns. The legislative efforts were tracked and programming changes were readied in case the legislation became law late in the year.



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### **Appendix I**

#### **Detailed Objective, Scope, and Methodology**

The overall objective of this audit was to determine the state of readiness of the Internal Revenue Service (IRS) to accept individual electronically filed tax returns for processing during the 2003 Filing Season.<sup>1</sup> Tax law changes for Education and Retirement (to coordinate with the Austin Request for Information Services (RIS) audit<sup>2</sup>) of significant impact were determined to be:

- Coverdell Education Savings Account distributions.
- Educator Expenses.
- Individual Retirement Arrangement Deduction.
- Retirement Savings Contribution Credit deduction.

To accomplish the objective, we:

- I. Determined if Reject Codes for the new tax law changes had been created for electronically filed tax returns.
  - A. Reviewed IRS manuals and RISs for inclusion of RISs for 2003 processing changes.
  - B. Interviewed IRS management in various Electronic Filing Branches to determine how the RISs were used.
- II. Determined how the Systems Acceptability Test (SAT) tests the programming changes for the new tax laws to ensure their thoroughness and accuracy.
  - A. Interviewed SAT office employees to determine if they addressed all new tax law changes.
  - B. Reviewed a copy of information used to test the RIS issues.
  - C. Attended a presentation by the SAT office of how it tests the programs and followed the programming through the various subsystems.
- III. Determined if the Participants Acceptance Testing System (PATS) addresses the new tax law changes related to education and retirement.
  - A. Interviewed PATS employees to determine if they addressed all new tax law changes.

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<sup>1</sup> Filing Season refers to the first half of the calendar year when most individual income tax returns are filed and processed.

<sup>2</sup> *Requests for Information Services Required for Tax Law Changes That Impact the 2003 Filing Season* (Audit Number 200240081).

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- B. Reviewed a copy of information used to test the RIS issues.
- IV. Determined if Electronic Tax Administration policy decisions had been communicated and coordinated with the Wage and Investment Division's Customer Account Services function.
  - A. Interviewed Customer Account Services management for 2003 Filing Season coordination efforts.
  - B. Researched websites for meetings where information has been distributed.

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**Appendix II**

**Major Contributors to This Report**

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**Appendix III**

**Report Distribution List**

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